$50.00 ANNUALLY
40 Letters Per Year

DOW THEORY LETTERS INC.

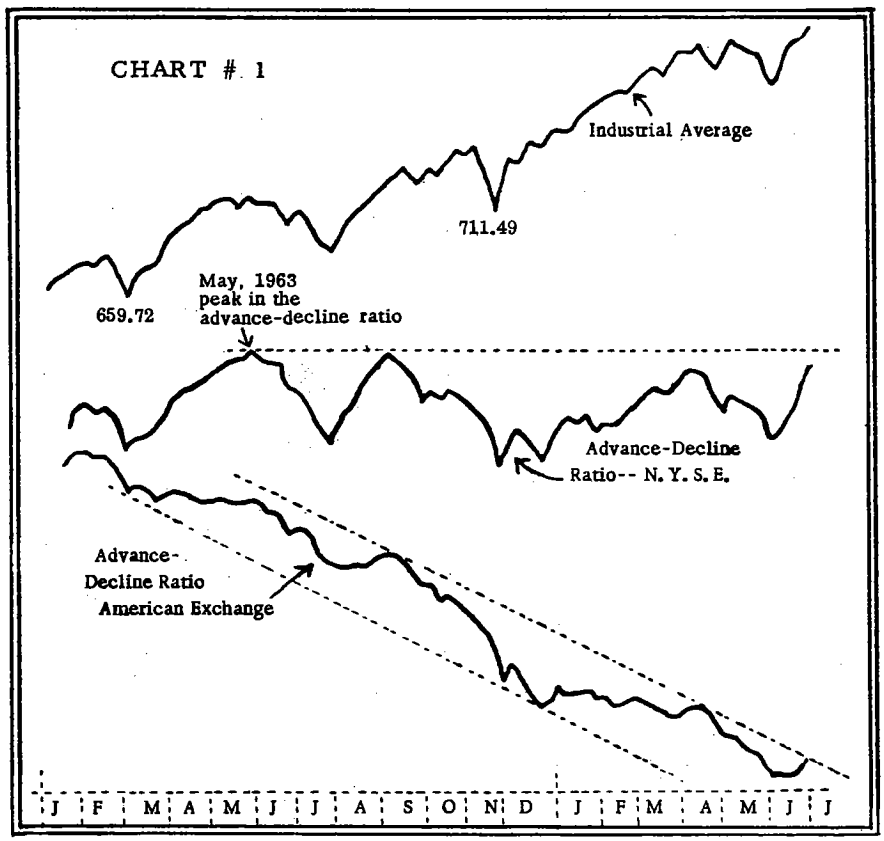
"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

Registered with the Securities and Exchange Commission

All Rights Reserved

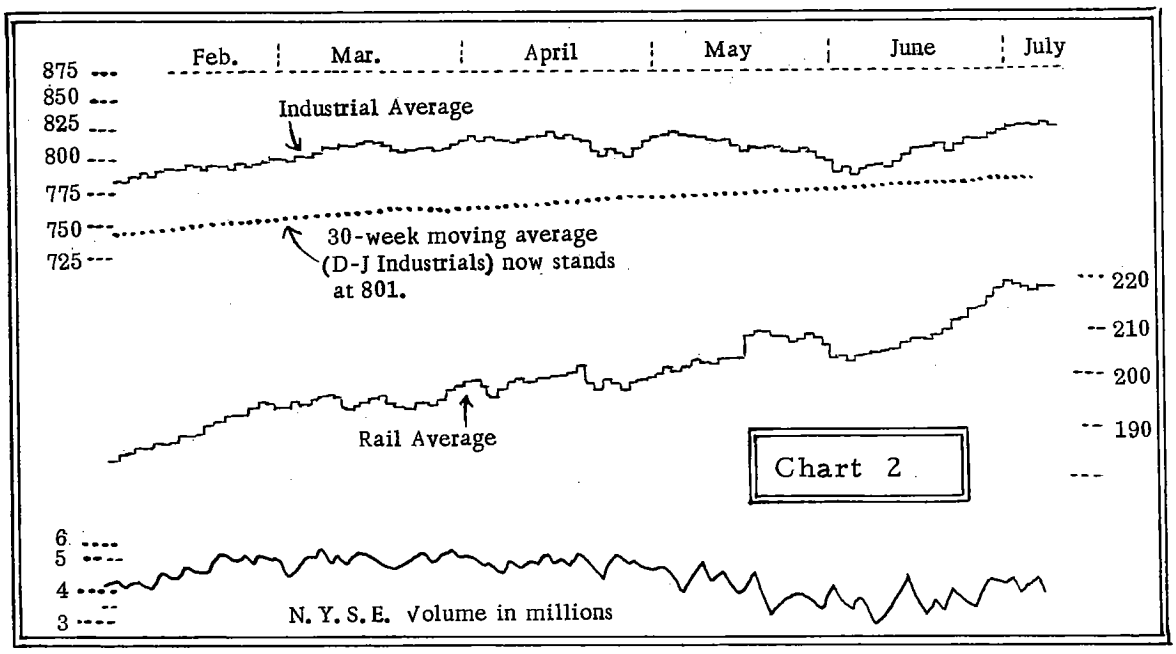
THE MARKET: The fire under the market "boiler" has been burning bright. This observer believes that the boiler is now at the point where it will either (1) bubble over —by way of a general market "blow-off", or (2) release the escape value — via a secondary reaction or bear market. We appear to be at the crossroads, and I list my reasons for this conclusion below:



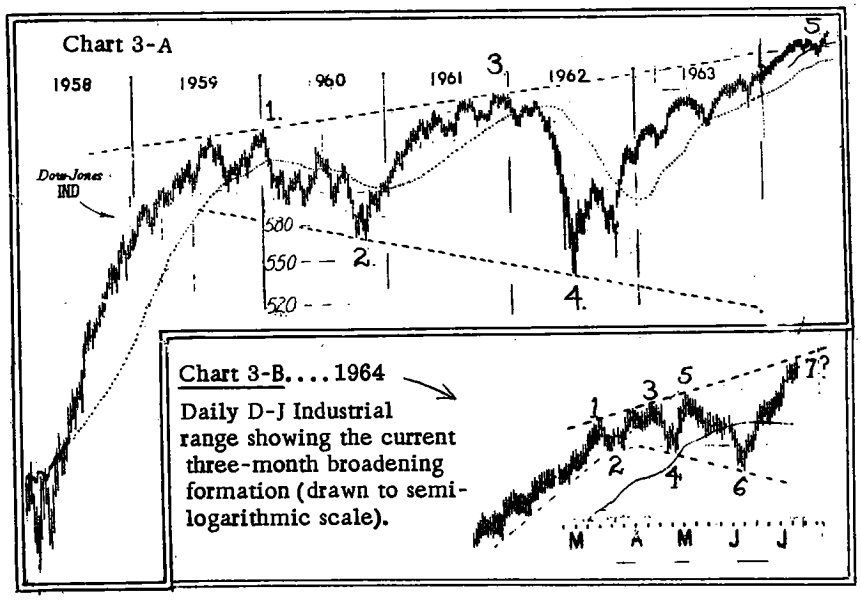
(1) The Industrial Average is now treading the upper trendline of the "broadening formation" which has been discussed in detail in recent Letters (see Chart 3-B). The final breakout from a broadening pattern is usually violent (regardless of whether the resolution is up or down). Furthermore, the current four-month broadening pattern (see Letter 258) is actually part of a much larger broadening effect which has been in the process of formation since 1959 (Chart 3-A). Time is running out for a resolution of these two extraordinary patterns. Readers should remember that regardless of any upside action which may be forthcoming, broadening patterns "make their appearance as a rule only at the end or in the final phases of a long bull market" (from Technical Analysis of Stock Trends by Edwards and Magee).

(2) On July 10 the advance-decline ratio bettered its preceding April, 1964, peak (chart 1). This puts the ratio within striking distance of its May, 1963, high. The current rise represents the third attempt by the A-D ratio to better the 1963 peak. A successful penetration of that peak (or a third failure) could have extremely important implications for the whole market.

(3) The advance-decline ratio on the speculative American Exchange (chart 1) is now pushing against the top of a channel which has been in effect since January, 1963. A reversal of this channel to the upside could mark the beginning of important activity on the Amex. Conversely, a failure and subsequent downturn could spell another

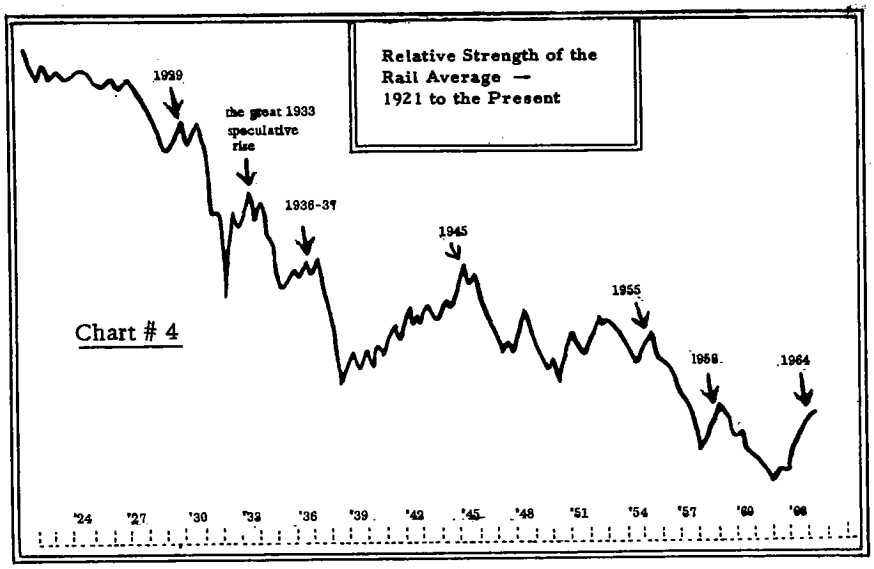


fizzle in speculative sentiment on both the Amex and the N. Y. S. E.



(4) Odd-lotters have been on the buying side of the market for the past week, following many months of steady selling (although some analysts dismiss the current odd-lot buying as unimportant, believing it to represent heavy public buying in only one stock — American Telephone). At any rate, this switch to odd-lot buying could represent a rise in public participation in the market. Public interest is a necessary ingredient for every speculative market blow-off. It is also an early sign of technical deterioration.

(5) Rail relative strength is now in its sharpest rise since 1958. While a rising trend in Rail popularity has not always implied a speculative explosion in the market, almost every final bull market blow-off has been accompanied by great interest in Rail equities. Following a poorer-than-the-market performance from 1921 to 1928, Rails gathered a great following during 1928 and 1929. Rails performed much worse than the market during 1929-32. In 1936-37 (corresponding with that bull market top) Rail relative strength turned up again. Rail popularity sagged during late 1937, but from 1938 to the mid-1940's Rails performed better than the market. During 1945 (at the top of the 1942-46 bull market) Rail relative strength was up sharply. Rails next gained in popularity during 1958 and early 1959, then slumped in 1961 to their lowest relative strength on record. Rail relative strength turned up in early 1962, and as of this month relative strength in the Rail group rose to its highest level since the 1959 peak. Conclusion: when Rails act better than the general market, the background is ripe for important (often violent) speculation. It is also well to remember that many major market tops have come out of periods in which Rails were putting on a great speculative "show" (it may interest readers to know that the current 3.5% yield on the D-J Rail Average is the lowest yield since the 1937 top). I have included Chart 4 which is a rare study of Rail relative strength from 1921 to 1964.



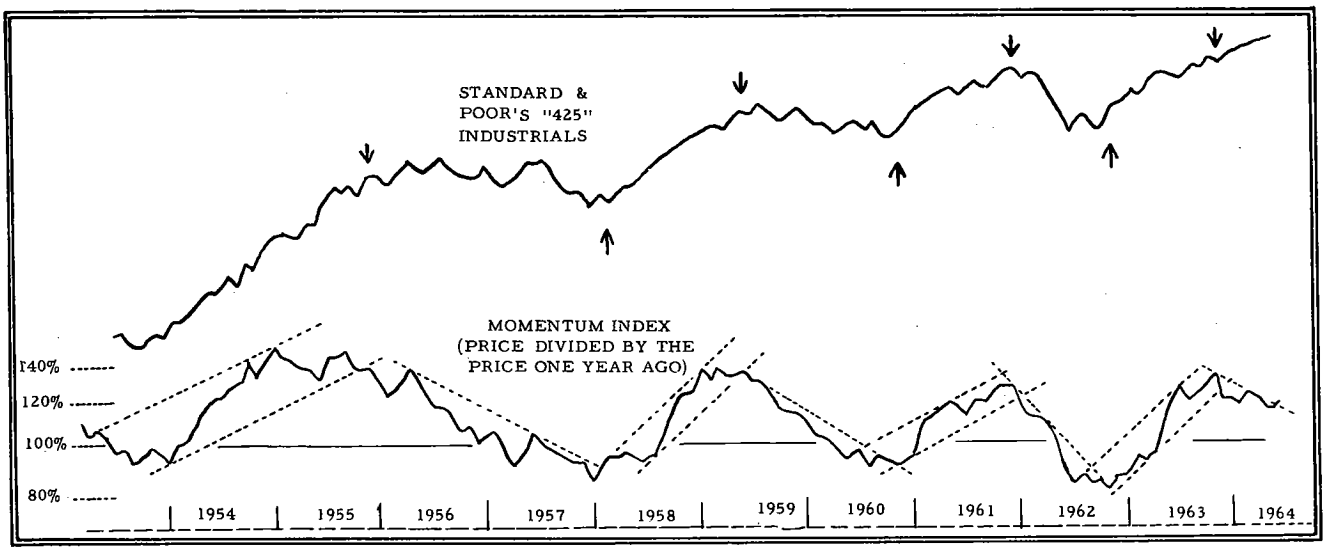
(6) On July 7 Utilities finally bettered their 1929 high of 144.61. This means that for the first time in 35 years, all three D-J Averages are in all-time high territory. The technical situation lends a speculative "flavor" to the whole market picture. The writer is also of the opinion that it is another sign of a maturing bull market.

(7) On July 10 General Motors rose to a new all-time high of 92 1/4, thereby bettering its late October (1963) peak of 91 3/8. Although this has no "predictive" value as far as the market is concerned, it removes a psychological barrier (markets almost never continue to advance more than six months beyond a peak in GM).

MOMENTUM INDEX: This index was described in detail in Letter 253. The momentum index traces the percentage of change in the broad Standard & Poor 425 Average over the past year. The index is computed by dividing the current (end of the month) price of the 425 by the price of that same index exactly one year ago.

As long as the index is above 100 we know that the 425 is higher than it was one year ago, and the converse is true when the index drops under 100. But the main use of the momentum index is to show the direction of momentum. A chart of many years of this study shows that the index tends to form extended channels, and most of these channels last from a year to three or four years. The channel phenomenon can be seen on the accompanying chart (page 3).

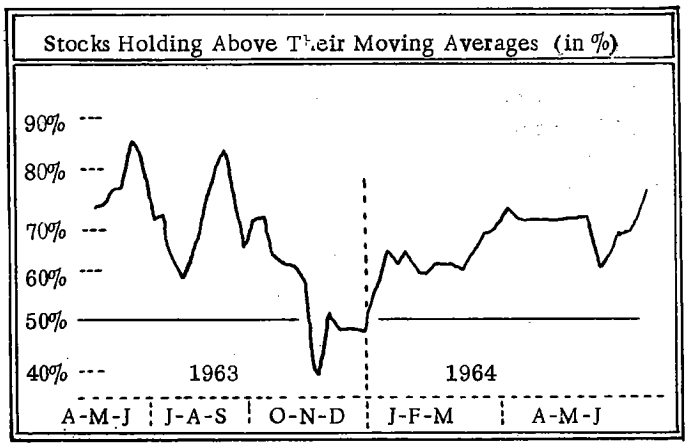
The penetration of a channel usually calls for an approaching top or bottom within one to six months. However, there have been a few periods such as 1951 and 1955 when a downside channel penetration preceded a top by 12 to 18 months.



The peak of momentum for the current rise occurred in November, 1963, with a reading of 132 on the index. The index dropped steadily during 1964, striking a low of 115 at the end of May. The latest figure for the end of June shows a jump to 119 in the index (see chart). Note that the June posting has succeeded in penetrating the declining trendline which connects the November and March peaks.

This brings up the question: has momentum turned up on a trend basis again? Answer: judging from past action, I feel that the declining channel since October, 1963, has been too short in duration and extent to suggest that a new upward phase has begun. My guess is that the 132 level of November, 1963, will prove to have been the peak. However, the upward penetration of the recent (declining) trendline is a sign that the market has not "given up the struggle". The momentum index presents a picture of a market which is wracked by conflicting forces. It is a market (as gauged by the momentum index) which has not fully made up its mind as to what it is going to do next.

STOCKS: Of 432 representative stocks which are tabulated here weekly, 326 (75%) are now holding above their long-term or 200-day moving averages. This is a jump of 5% from last week and is the strongest showing since September, 1963 (see accompanying chart).



I am placing particular emphasis on selection of individual stocks at this time. The fact is that it is (and has been) difficult to pick stocks which will "gather a following" and actually move out. It has also been difficult to find stocks which are (1) reasonably close to recent lows (or what I term "give-up" points), (2) in formations which give promise of forthcoming major advances.

Selection of stocks is a matter of instinct and careful analysis, both blended together in a manner which is somehow calculated to make sense and inspire confidence in the buyer. Stock selection methods have always run in fads, and these fads continually change along with the times and the relative success of the individual method. For instance, during the 1940's and early '50's, great attention was given to fundamentals, book values, dividend records, etc. In the early stages of the bull market this type of research often proved highly successful since almost all stocks were moving up, and the best values often made the best progress.

But after 1956 the market became increasingly selective, and with the advent of new problems, the fundamentals did seem to be enough. Public interest in the market heightened during the later 1950's and along with greater public participation came sharper secondary reactions. Timing was now extremely important, regardless of fundamentals. Moreover, increased emphasis was being placed on special groups, "glamour stocks" and individual speculative favorites. Since greater skill in timing and selectivity was needed, market practitioners turned their attention increasingly to the technical approach.

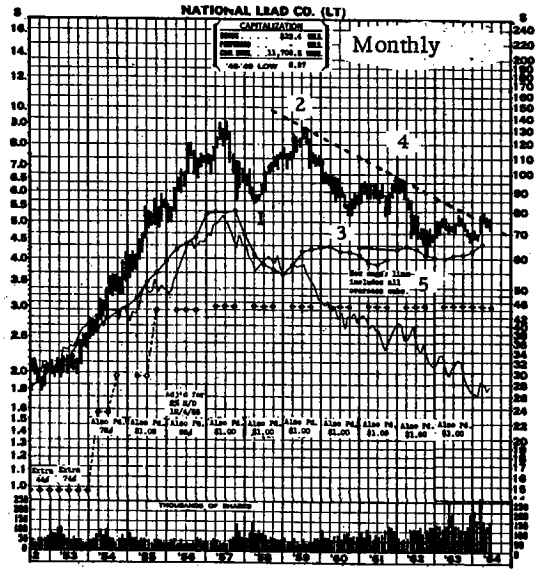
One of the greatest boosts ever given a method was handed to technical analysis when John Brooks published his series on John Magee and the technical approach in the New Yorker Magazine during the mid-1950's. In the late 1950's this writer published a series of articles in Barron's following almost two decades in which that leading Wall Street publication handled almost nothing in the way of technical market studies (Barron's was a pioneer in technical analysis during the 1930's). The Barron's

series went a long way towards popularizing the Dow Theory and the technical approach.

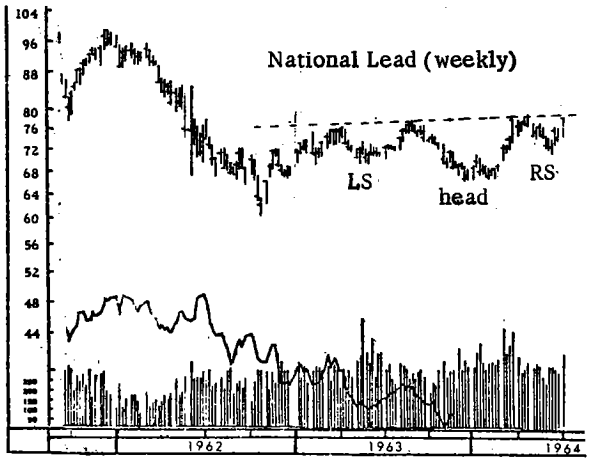
It is probable that market methods are about to make the full circle. From the scorn and derision which buffeted technical analysis during the 1950's, this approach now enjoys such wide acceptance that its earlier practitioners have grown somewhat suspicious of it — both as applied to the market and as applied to individual stocks. For this reason, I myself suspect that when this market turns, there will be little if anything in the (more obvious) technical picture which will actually identify the top. In fact, it is entirely possible that following the top, market students will look back in wonderment and say: "Blast it, nothing in the technical picture pin-pointed or even forewarned of the turn. It was the fundamentals — stocks were just too high!" It could be as simple (and deceptive) as that.

Many readers expressed interest in last week's discussion of "five major legs" as the probable completion of a major movement (see Burroughs in the last Letter). This, of course, is from the observations of R. N. Elliot back in the 1930's. The Elliot Principle (as with anything in the market) does not always work, but it works often enough to be interesting.

National Lead is a quality stock in the building supply group which completed a major 5-leg decline between 1957 and 1962. LT recently reversed its major declining trendline (see monthly chart), and an important new advance could be in the making. Since the 1962 low, LT has traced out what appears to be a massive "head-and-shoulder reversal" pattern as seen on the weekly chart. The upside breakout from this base would be a move above 80. I consider LT to be one of the most interesting speculations on the Board.



W. T. Grant in the retail variety chain group has shown an important reversal in a 3-year downtrend in relative strength (see monthly chart). The variety chain group has been one of the most depressed groups on the Board, its group relative strength having touched its lowest level in history this year. The turn in Grant could therefore be significant, and it has occurred to the accompanyment of quite a bit of insider buying. The smaller chart shows GTY moving out strongly with the stock well above its 10-week moving average which in turn is above its 200-day moving average. GTY is an attractive situation at this time.



MGM was recommended at 36 and I include a chart of this issue for the third week in a row. This time it is a point & figure chart. P & F diagrams often show important bases or tops in more dramatic terms than bar charts, and here we see the huge base in MGM, a base that has been building since 1962. After breaking out at 38, the stock has continued to climb into the '40's. P & F charts often offer a "count" or price objective. While far from infallible, these counts are nevertheless interesting. The base of MGM counts 18 boxes across. Applying the figure 18 to the point of breakout, we obtain a potential of 56. Time will tell us how accurate this upside count is.

Chart 3-A and 3-B and small weekly chart of GTY courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas. Weekly chart of LT courtesy of Traders Research, 1431 Pearl Avenue, Alton, Illinois 62003. Monthly chart of LT courtesy of Securities Research, 211 Congress St., Boston, Massachusetts 02110. Monthly chart of W. T. Grant courtesy of Ray * Signals, 141 Broadway, New York 6, New York.